No. 87-654

In the Supreme Court of the United States

OCTOBER TERM, 1987

NEW ENERGY COMPANY OF INDIANA,

Appellant,

v.

JOANNE LIMBACH, TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW, TREASURER OF OHIO, AND SOUTH POINT ETHANOL,

Appellees.

On Appeal from the Supreme Court of Ohio

BRIEF OF APPELLEE SOUTH POINT ETHANOL

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QUESTION PRESENTED

Whether an Ohio statute violates the Commerce Clause by providing that a special incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that provides no similar incentive for fuel containing ethanol produced in Ohio, despite the statute's lack of either a protectionist purpose or a detrimental effect on interstate commerce.

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At issue on this appeal is the validity of Ohio Rev. Code § 5735.145(B), which provides that a special incentive to fuel dealers designed to encourage the production and use of ethanol in Ohio and other states is inapplicable to fuel containing ethanol produced in a state that does not provide a similar incentive for ethanol produced in Ohio. Appellant New Energy Company of Indiana ("New Energy") has abandoned challenges based on the Privileges and Immunities and Equal Protection Clauses of the United States Constitution and appeals only on the theory that § 5735.145(B) offends the Commerce Clause. Because New Energy failed to prove that § 5735.145(B) has either a protectionist purpose or a detrimental effect on interstate commerce,

this Court should affirm the decision of the Supreme Court of Ohio rejecting New Energy's Commerce Clause challenge.

STATEMENT

A. The Ethanol Industry

Resolution of New Energy's claim that § 5735.145(B) contravenes the Commerce Clause requires an understanding of the nature of the commerce at issue. The trial court heard extensive testimony concerning the structure and economics of the country's emerging ethanol industry. This testimony made clear that the market for ethanol is driven, not by private market forces, but by governmental policies designed artificially to stimulate its production and use. The commerce in question, in other words, is dependent for its existence upon the very form of governmental incentives at issue on this appeal.

Ethanol is a form of alcohol which has increasingly been recognized as a beneficial fuel additive to enhance the octane rating of gasoline without contributing additional lead emissions into the environment (Findings 9, 10, J.A. 25).[1] Because it is a cost-effective and environmentally benign replacement for lead in gasoline, ethanol is the most promising octane-boosting fuel additive currently available. (Finding 10, J.A. 25). In addition, because ethanol is derived primarily from corn, it provides a market for the sale of surplus corn. (Findings 9, 10, J.A. 25). Other benefits resulting from the use of ethanol include boosting rural economies and reducing dependence on foreign oil. (J.A. 51, 58-59).

[1] J.A. refers to the Joint Appendix. J.S.A. refers to the Appendix to Appellant's Jurisdictional Statement.

Despite the many advantages associated with ethanol use, the evidence at trial made clear that fuel made from gasoline blended with ethanol ("gasohol") cannot compete with gasoline without government support. New Energy's chief executive officer described the economics of ethanol production and stated flatly that "[u]nfortunately a gallon of ethanol is far more costly than a gallon of gasoline at this time." (J.A. 64). In a free market, ethanol producers could not sell their product at a price sufficient to cover their production costs; if the price of ethanol reflected the cost of producing it, consumers would purchase regular gasoline rather than gasohol, and commerce in ethanol would come to a halt. (J.A. 63-65, 71-77, 147-149).

Recognizing that private market forces do not provide a sufficient incentive for using ethanol as a motor vehicle fuel additive and that such market forces alone would not generate the substantial economic and noneconomic benefits of ethanol use, the federal government and a number of states initiated programs to encourage ethanol production and use. (Findings 10, 11, 13, New Energy Finding 11, J.A. 25-26, 30-31). The most effective of these programs have involved tax credits, which have been employed by the federal government and at least thirty-two states, including Ohio, to make ethanol economically viable. (Findings 11, 13, New Energy Finding 11, J.A. 25-26, 30-31).

The undisputed evidence at trial indicated that these credits are, for all practical purposes, responsible for the present existence of substantial interstate commerce in ethanol. The evidence showed, in fact, that without federal and state tax incentives, the existing interstate market for ethanol would not survive. New Energy's chief executive officer was asked, "With this difference in cost [between gasoline and ethanol] then, would you explain to the court how you would remain

competitive and induce a consumer to purchase ethanol or ethanol blends rather than regular gasoline?" He responded:

> The only way we can currently do so is through the state and federal incentives or credits that exist, and *absent those credits . . . ethanol would not be a viable factor in the market place today.*

(J.A. 65, emphasis added). He further explained the applicability of this general principle to the Ohio ethanol tax credit and, in so doing, made clear that gasohol could not compete effectively with gasoline *in Ohio* without that credit. (J.A. 73-76, 147-149).[2] If there were no Ohio credit, Ohio fuel dealers would purchase gasoline instead of gasohol, and the allegedly burdened commerce in ethanol would dry up.

Belatedly recognizing what it had admitted by this evidence, New Energy has improperly presented to this Court a number of alleged "facts" that were not part of the record below concerning the existence of an ethanol market in states that provide no tax incentives.[3] In referring to these materials, New Energy apparently seeks to retract its contention throughout this case that

[2] As New Energy concedes, "*[w]ithout the Ohio credit*, the equivalent wholesale price of gasohol is a half cent more than gasoline. At this price, *ethanol is unattractive to the dealer . . . .*" (Brief for Appellant at 6 n.2, emphasis added).

[3] The so-called "evidence" which New Energy supports by reference to the following sources was not presented to the trial court: *Alcohol Update* (Jan. 26, 1987), (Mar. 9, 1987), (Dec. 21, 1987) (cited in Brief for Appellant at 7, 8, 20, 21); Vaughn, Testimony before House Subcommittee on Energy and Power (June 24, 1987) (cited in Brief for Appellant at 8); Siegel, Carr, Gelb & Mielke, *Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline* (Oct. 13, 1987) (cited in Brief for Appellant at 5); and U.S. Motor Fuel Legislative and Regulatory Service (1987) (cited in Brief for Appellant at 8, 21).

"ethanol would not be a viable factor in the market place today" absent federal and state tax incentives. (J.A. 65). This information is not only improperly before the Court, but also is wholly inadequate to rebut New Energy's evidence at trial that the existence of an ethanol market, and indeed New Energy's own ability to market ethanol, depends upon federal and state incentives.[4]

B. The Ohio Legislation And Its Impact

Along with the federal government and many other states, Ohio has recognized the benefits of ethanol use and has provided tax incentives to subsidize the sale of ethanol. (Findings 11, 13, New Energy Finding 11, J.A. 25-27, 30-31). Although it could have chosen (as did New Energy's state, Indiana) to encourage the in-state production of ethanol by directly subsidizing only Ohio ethanol producers, Ohio's General Assembly was willing indirectly to subsidize both in-state and out-of-state producers. This litigation arose because Ohio's willingness to subsidize out-of-state producers has not been completely unlimited: that willingness has instead been conditioned on the availability in those producers' states of a similar indirect subsidy for ethanol produced in

[4] The fact that incentives are necessary to the economical marketing of ethanol is supported by the findings of the United States Department of Agriculture and the General Accounting Office, as well as the undisputed testimony of New Energy's chief executive officer. *See* U.S. Department of Agriculture, *Ethanol: Economic and Policy Tradeoffs* 2 (Jan. 1988) ("The fuel-ethanol industry was created by a mix of Federal and State subsidies, loan programs and incentives. It continues to depend on Federal and State subsidies."); Report of the U.S. General Accounting Office, *Importance and Impact of Federal Alcohol Fuel Tax Incentives* 8 (June 6, 1984) (There was essentially no domestic ethanol before incentives were enacted and without incentives "there would not be a domestic fuel ethanol industry today.").

Ohio, a limit which was intended, among other things, to encourage other states to enact ethanol tax credits and which is fully consistent with the goal of stimulating ethanol production and use on a national basis. (New Energy Finding 21, State Finding 1, J.A. 31, 44).[5]

The Ohio ethanol credit is tied to a fuel tax that Ohio imposes on retail dealers for each gallon of gasoline sold in the state. Ohio Rev. Code Ann. § 5735.01 *et seq.* (Baldwin 1988). Under § 5735.145, fuel dealers are granted a credit toward this tax of 2.5¢ per gallon for the sale of gasoline that is blended with not more than ten percent ethanol. This credit is available for gasoline blended with ethanol produced in Ohio or any other state, unless the state of origin does not grant "an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio. . . ." Ohio Rev. Code Ann. § 5735.145(B) (Baldwin 1988).

Ethanol produced in numerous other states is eligible for Ohio's special incentive, and much ethanol produced outside of Ohio is available to Ohio retailers. (Finding 17, J.A. 28). The only ethanol producer with an Ohio production facility is appellee South Point Ethanol ("South Point"). Out-of-state producers who sell to Ohio dealers include Archer Daniels Midland ("ADM"), Pekin Energy ("Pekin"), and A.E. Staley ("Staley"). (*Id.*). ADM, the largest domestic producer of ethanol, and Pekin have production facilities in Illinois, and Staley has production facilities in Tennessee.

[5] New Energy states that the trial court failed to adopt a proposed finding that one of the purposes of § 5735.145(B) was "to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead gasoline not only in Ohio but in all states." (State Finding 1, J.A. 44). Brief for Appellant at 13. The trial court *did*, however, adopt this finding of fact. (J.S.A. 56a).

Ohio dealers selling gasoline blended with ethanol produced by ADM, Pekin, or Staley in Illinois or Tennessee, as well as with ethanol produced by South Point, are entitled to Ohio's ethanol tax credit. (*Id.*).

Ethanol produced in Indiana by New Energy, however, no longer qualifies for the Ohio tax incentive because Indiana decided in 1984 to limit its support of ethanol production to in-state producers. In implementing this decision, Indiana eliminated its ethanol tax credit, which was available for ethanol produced in other states as well as in Indiana, and replaced it with a direct subsidy available only to Indiana ethanol producers — of which New Energy was the only one. (J.A. 105-106).[6] As a result, Ohio fuel dealers who sell gasoline blended with ethanol produced by New Energy do not receive Ohio's ethanol tax credit.

The unavailability of the Ohio credit, the trial court found, will cause severe financial hardship to New Energy. (Finding 20, New Energy Finding 20, J.A. 29, 31). Section 5735.145(B) does not, however, preclude New Energy from selling ethanol in Ohio if it can do so economically without a financial subsidy from Ohio. (Finding 18, J.A. 28).

There was no evidence or a finding that the flow of interstate commerce would be adversely affected if the Ohio credit is denied to New Energy. On the contrary,

[6] Before New Energy began to compete in the Indiana ethanol market, Indiana encouraged the use of ethanol by applying a lower tax rate to all retail sales of gasohol than the rate for retail gasoline sales. In March 1984, in anticipation of New Energy's entry into the market, the Indiana legis'ature repealed the lower tax rate for ethanol, effective July 1, 1985, and replaced this lower tax rate with the Ethanol Fuel Production Incentive Grant, which in effect provided a direct subsidy available *only* to New Energy. (J.A. 68-69, 104-105). Following the trial in this case, Indiana law was amended to retain only 1¢ per gallon of gasohol subsidy. These grants have since been discontinued in Indiana.

the trial court found that ethanol producers from states other than Ohio, which are eligible for Ohio's incentive, can supply the portion of the Ohio ethanol market that New Energy supplied before § 5735.145(B) was enacted. (Finding 17, J.A. 28). Although the challenged statute may reduce New Energy's market share for ethanol in Ohio, New Energy presented no evidence that the statute was protectionist in its purpose or effect or that it would in any way affect the mix of in-state and out-of-state ethanol sold in Ohio or reduce the flow of ethanol into Ohio from other states.[7]

The evidence showed that rather than reducing the flow of ethanol sold in interstate commerce, the Ohio statute — along with similar federal and state incentives — actually increases interstate commerce in ethanol. By conditioning the provision of its credit on the availability of a like incentive for ethanol produced in Ohio, Ohio has encouraged the continued expansion of such interstate commerce.

SUMMARY OF ARGUMENT

New Energy's attack on the reciprocity provision of § 5735.145(B) wholly ignores the manner in which the challenged provision operates and relies instead on a hodge-podge of general principles applied with little or no analysis. In essence, New Energy relies on no more than the erroneous assumption that reciprocity provisions are invalid per se, regardless of their impact, or lack of impact, on interstate commerce. That assumption cannot withstand scrutiny, and New Energy's proof at trial provided no alternative basis for invalidating § 5735.145(B).

[7] New Energy's evidence at trial, in fact, supported precisely the opposite conclusion. (J.A. 79-80).

To the extent that Ohio's unwillingness to subsidize New Energy's ethanol production makes it uneconomical for New Energy to sell its ethanol in Ohio, no impermissible burden is imposed on interstate commerce. The record in this case demonstrates that the allegedly burdened commerce is commerce that would not exist without the Ohio incentive, not commerce that arises naturally in response to private market forces. Ohio's incentive may not be as broad as New Energy would like, but, in light of the nature of the ethanol market, the challenged statute is not "the kind of action with which the Commerce Clause is concerned." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 805 (1976).

The dependence of the Ohio ethanol market on the Ohio incentive also distinguishes this case from the reciprocity decisions on which New Energy relies. Unlike the reciprocity provisions in those cases, the Ohio incentive does not prevent or reduce the flow of interstate commerce. Instead, the statute encourages the flow of interstate commerce in ethanol.

New Energy has been unable to prove that § 5735.145(B) has either a protectionist purpose or effect. The record shows, and the trial court found, that the Ohio credit has the purpose of encouraging the production and use of ethanol. (Finding 11, New Energy Finding 11, J.A. 25-26, 30-31). The reciprocity provision enables Ohio to promote the advancement of this purpose not only in Ohio but in other states as well.

Finally, New Energy adduced no evidence at trial that § 5735.145(B) imposes any burden on interstate commerce. The record reveals that numerous out-of-state producers are active in the Ohio market, eligible for the Ohio incentive, and able to fill any gaps in the market which might result from a withdrawal by New Energy. To the extent that the statute is subjected to

Commerce Clause scrutiny, therefore, it clearly passes muster.

ARGUMENT

I. The Commerce Allegedly Burdened By Ohio Rev. Code § 5735.145(B) Depends For Its Existence On The Challenged Incentive.

New Energy does not contend that Ohio has created a *barrier* to interstate commerce in ethanol. Its argument is that the Commerce Clause has been violated because the *incentive* to such commerce embodied in Ohio's ethanol tax credit has not been extended to ethanol produced by New Energy in Indiana. Nothing in this Court's Commerce Clause jurisprudence supports this result.

Ohio's ethanol incentive program does not represent an attempt by the state to "place itself in a position of economic isolation," and the program has not placed "an unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).[5] The incentive program imposes no prohibitions on the interstate movement of ethanol. In fact, the Ohio incentive promotes interstate commerce; it is undisputed that the incentive has increased the amount of ethanol placed in interstate commerce and that its elimination would significantly lessen the volume of interstate commerce in ethanol. (J.A. 65). Indeed, this positive effect on the volume of commerce in ethanol was a principal aim of the legislation.

As a result, New Energy's discussion of the effect of § 5735.145(B) and whether or not any adverse effect entitles New Energy to relief under the Commerce

[5] See Brief for Appellant at 21-22. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976).

Clause is unpersuasive. It amounts to a claim that New Energy is *entitled* to receive Ohio's aid. New Energy's argument implicitly assumes that the company had some sort of constitutional right to receive aid from Ohio, and that any injury caused by a limitation placed on the availability of the credit is one for which the Commerce Clause provides a remedy.

For Commerce Clause purposes, this cannot be the correct method of analyzing the impact of § 5735.145(B). Neither New Energy nor any other ethanol producer, whether located in Ohio or elsewhere, has a constitutional right to receive supportive subsidies or incentives. At best, New Energy is only entitled to reap whatever benefit it can derive from the natural functioning of the free marketplace. The question whether § 5735.145(B) has a constitutionally cognizable impact by disrupting the natural market position to which New Energy has a right can be resolved only by comparing New Energy's position after enactment of the section to the position it would enjoy if Ohio provided *no* ethanol tax credit. When this comparison is made, the only conclusion supported by the record is that § 5735.145(B) does not put New Energy in a position any worse than the one in which it would find itself in the absence of any Ohio ethanol tax credit.[9]

New Energy's chief executive officer testified that his company would be unable to market ethanol profitably in Ohio without the Ohio tax credit, because the price it would receive would be too low in relation to production costs. (J.A. 63-65, 71-77, 147-149). This evidence translates directly into a conclusion that without the Ohio incentive there would be *no* commerce for

[9] New Energy may well have been in a better position before the enactment of § 5735.145(B), but it enjoyed that position as a result of Ohio's generosity and not as a matter of right.

New Energy in ethanol in Ohio.[10] New Energy, this evidence makes clear, is "not in the position of a foreign business which enters a State in response to completely private market forces to compete with domestic businesses, only to find itself burdened with discriminatory taxes or regulations." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 n.20 (1976). New Energy is instead confronted with the reality that the economics of its business are such that, given the operation of private market forces, its product, ethanol, costs more to produce than New Energy can charge and still compete effectively with the alternative product, gasoline, that ethanol is intended to replace.

The fact that Ohio provides an incentive to obviate this reality for ethanol produced in Ohio and numerous other states, but no longer does so for ethanol produced by New Energy in Indiana, because Indiana provides no similar incentive for ethanol produced in Ohio, does not trigger Commerce Clause concerns. The Commerce Clause rests on the premise that "this Nation is a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods *in response to the economic laws of supply and demand*." *Alexandria Scrap*, 426 U.S. at 803 (emphasis added). "The common thread in all these [Commerce Clause] cases is that the State interfered with *the natural functioning of the interstate market* either through prohibition or through burdensome regulation." *Id.* at 806 (emphasis added). Where the affected commerce does not result from "the natural functioning

[10] New Energy has in effect conceded that the Ohio incentive is essential to the existence of an Ohio market for New Energy's ethanol by not challenging the credit itself. New Energy has instead only challenged the reciprocity provision of the Ohio incentive program which allocates the credit among the various ethanol producers.

of the interstate market" but rather is "created, in whole or substantial part," by the challenged state statute, *id.* at 809 n.18, the statute does not give rise to "a burden which the Commerce Clause was intended to make suspect." *Id.* at 807.

This case squarely presents the question alluded to in the majority and concurring opinions in *Alexandria Scrap*, which rejected a Commerce Clause challenge to a Maryland statute offering a state bounty on inoperable automobile hulks.[11] The Maryland statute had the effect of disadvantaging all out-of-state scrap processors in relation to in-state processors. Although the case was decided on the ground that the state was acting as a market participant, Justice Powell observed in his majority opinion, in language directly applicable to the Ohio ethanol incentive,

> that the commerce affected by the 1974 amendment appears to have been created, in whole or in substantial part, by the Maryland bounty scheme. We would hesitate to hold that the Commerce Clause forbids state action reducing or eliminating a flow of commerce *dependent for its existence upon state subsidy instead of private market forces.*

426 U.S. at 809 n.18 (emphasis added).

Justice Stevens' concurring opinion in *Alexandria Scrap* explained this concept more fully:

> It is important to differentiate between commerce which flourishes in a free market and commerce which owes its existence to a state subsidy program. Our cases finding that a state regulation constitutes an impermissible

[11] The issue was not "clearly presented" in *Alexandria Scrap* "[b]ecause the record contain[ed] no details of the hulk market prior to the bounty scheme. . . ." 426 U.S. at 809 n.18. *See also Reeves, Inc. v. Stake*, 447 U.S. 429, 446 n.18 (1980).

> burden on interstate commerce *all dealt with restrictions that adversely affected the operation of a free market.* This case is unique because, the commerce which Maryland has "burdened" is commerce which would not exist if Maryland had not decided to subsidize a portion of the automobile scrap-processing business.

Id. at 815 (emphasis added);[12] *see also* Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1196 nn. 202, 203 (1986).

Justice Stevens was surely correct in observing that the many cases invalidating state regulation under the Commerce Clause, including those on which New Energy relies here, "all dealt with restrictions that adversely affected the operation of a free market." 426 U.S. at 815; *see also id.* at 806 (majority opinion). Invalidation of § 5735.145(B) would require a broad and unwarranted extension of the principles underlying those cases. As the Court expressly recognized in *Alexandria Scrap*, it is one thing to say that interstate commerce is burdened when a state imposes a discriminatory tax on a foreign business whose participation in the state's economy is motivated by the competitive forces of the free market, but quite another to say that interstate commerce is burdened by a state's rational failure to extend to all foreign businesses a subsidy for a product that is too costly to attract customers in a free market. *Id.* at 810 n.20.

[12] Justice Stevens noted that the result would not differ had the market been merely small rather than nonexistent before the bounty scheme was enacted: "[T]he analysis is the same whether we are dealing with the newly created portion of a pre-existing market or with an entirely new market." *Alexandria Scrap*, 426 U.S. at 815.

Viewed in this way, § 5735.145(B) does not impose any impermissible burden on interstate commerce. Ohio has created a tax incentive — applicable to both in-state and out-of-state ethanol — to encourage the production and use of ethanol. By so doing, Ohio has given rise to commerce that would not exist without the incentive. Just as Ohio could not be criticized under the Commerce Clause for failing to create that commerce in the first instance, the state cannot be said to have burdened interstate commerce by limiting the availability of its incentive in order to induce other states to create similar incentives. *Alexandria Scrap*, 426 U.S. at 815-817 (Stevens, J., concurring).[13] In such circumstances, where the state has no obligation to create the market or to subsidize out-of-state businesses, "[w]hether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on interstate commerce." *Id.* at 816 (Stevens, J., concurring). The "burden" caused by nonreceipt of the benefit of § 5735.145(B) is not "the kind of action with which the Commerce Clause is concerned." *Alexandria Scrap*, 426 U.S. at 805.

> [13] [T]here must have been countless situations during the past two centuries in which the several States have experimented with different methods of encouraging local enterprise without providing like encouragement to out-of-state competitors. The absence of any previous challenge to such programs reflects, I believe, a common and correct interpretation of the Commerce Clause as primarily intended (at least when Congress has not spoken) to inhibit the several States' power to create restrictions on the free flow of goods within the national market, *rather than to provide the basis for questioning a State's right to experiment with different incentives to business.*

Id. at 817 (emphasis added).

II. The Statutory Limit On Ohio's Willingness To Subsidize The Growth And Development Of Interstate Commerce In Ethanol Is Fully Consistent With This Court's Reciprocity Decisions.

One of the purposes supporting the enactment of § 5735.145(B) was the promotion of industry generally by influencing other states to enact similar incentives to encourage the use of ethanol. (J.S.A. 63a). New Energy decries this purpose, relying heavily on *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 106 S. Ct. 2080 (1986), and two decisions invalidating state statutes with so-called reciprocity provisions, *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976) ("*A&P*"), and *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982). None of these cases calls into question the validity of § 5735.145(B).

As an initial matter, neither *Baldwin* nor *Brown-Forman* involved an inducement by one state to affect another state's legislative policy. Both cases involved statutes that regulated the primary conduct of foreign businesses in transactions occurring entirely outside the state. Moreover, both cases involved regulation of commerce generated by completely private market forces.

In *Brown-Forman*, for example, a New York law prohibited the wholesale sale of liquor at prices any higher than the lowest price the seller would charge for its product elsewhere in the United States during the same month. The statute was challenged by a distiller who was forced by the statute to discontinue out-of-state promotional programs by which the distiller offered special cash discounts to retailers to use for advertising purposes. The New York statute effectively regulated the price at which the distiller could sell its product in other states, and the Court held that New York's attempt to "'project its legislation into [other

States] by regulating the price to be paid' for liquor in those States" violated the Commerce Clause. 106 S. Ct. at 2086 (quoting *Baldwin*, 294 U.S. at 521). Section 5735.145(B), in contrast, only affects transactions in Ohio. It has no effect on what New Energy is allowed to do in Indiana or in any other state. To be sure, the impact of the statute on New Energy's effort to sell ethanol in Ohio may be designed to influence the conduct of the Indiana legislature, but that is not a topic that the Court addressed in *Brown-Forman*; it clearly is not something that the Court in any way suggested was unconstitutional.[14]

Baldwin has even less bearing on this case. At issue there was the validity of the New York Milk Control Act, which prohibited in-state sales of milk bought outside of New York unless the price to the out-of-state producer was no lower than the minimum price payable to New York producers. The avowed purpose of the Act was to increase milk prices in order to protect New York producers from out-of-state competition — "a classic illustration of economic provincialism." *Brown-Forman*, 106 S. Ct. at 2090 (Stevens, J., dissenting). As it did over fifty years later in *Brown-Forman*, the Court in *Baldwin* held that New York's indirect regulation of prices paid

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[14] The *Brown-Forman* Court did mention possible alterations of other state's regulatory schemes. 106 S. Ct. at 2087. This language, however, must be read in context. What the *Brown-Forman* Court was concerned about, and what this case does not involve, was an attempt to regulate transactions occuring wholly outside of the state. The type of promotional scheme which appellant in *Brown-Forman* had in mind was legal in many other states, but could not be accomplished in those states if appellant complied with New York law. While the other states could alter their laws to permit appellant to do what it wanted while still complying with New York law, the object of the New York statute was not to encourage them to do so, and the effect of the statute was to regulate transactions in other states.

in other states to producers located in those states unduly burdened interstate commerce. 294 U.S. at 524. That holding has no more impact on the validity of Ohio's purpose in enacting § 5735.145(B) than does the later *Brown-Forman* decision.

Although they were decided under the Equal Protection Clause, the Court's recent decisions in *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1985), and *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648 (1981), shed far more light on this case than do *Baldwin* and *Brown-Forman*. Both *Ward* and *Western & Southern* involved discriminatory state taxes imposed on out-of-state insurance companies, and together they stand for the proposition that promoting the *in-state* business of domestic companies by penalizing foreign companies who also want to do business in the state is not a legitimate state purpose, but that promoting the *interstate* business of domestic companies by deterring other states from enacting discriminatory or excessive taxes is a legitimate state purpose. *Ward*, 470 U.S. at 876-78; *Western & Southern*, 451 U.S. at 671.

Ohio's ethanol incentive is designed to encourage the use of ethanol in Ohio and thus to spur its production in Ohio and elsewhere. It applies to both foreign and domestic ethanol, and is not intended to provide an advantage to Ohio ethanol producers at the expense of foreign ethanol producers who compete for the business of Ohio fuel dealers. There was no finding that the reciprocity limitation was intended to increase, or that it did increase, any Ohio producer's share of the *Ohio ethanol market*. Instead, the provision encourages other states to provide similar incentives, one effect of which is to enable Ohio ethanol producers — and quite probably a number of out-of-state producers — to market their product *in other states*.

As the Court noted in *Western & Southern*, citing two Commerce Clause decisions: "There can be no doubt that promotion of domestic industry by deterring barriers to interstate business is a legitimate state purpose." 451 U.S. at 671 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), and *Parker v. Brown*, 317 U.S. 341 (1943)). In other words, a state's promotion of local industry may be a valid purpose under the Commerce Clause if that purpose serves national rather than merely local interests. *Ward*, 470 U.S. at 876 n. 6. Ohio's statute has just such a valid purpose. By encouraging other states to enact similar incentives for ethanol production and use, § 5735.145(B) deters barriers to interstate trade in ethanol. Although the interests of local producers are served by the statute, numerous out-of-state producers are also benefited and the end goal — an open and substantial national market for ethanol — strongly serves national interests.

New Energy speaks in sweeping and general terms of Ohio's "discrimination" against business from other states, but fails to identify any barrier to interstate commerce created by the statute. The reason for this absence of proof is clear: the challenged statute imposes no such barrier and does not prevent the movement of ethanol in interstate commerce. As previously discussed in detail, the Ohio incentive is essential to the existence of the commerce that it allegedly burdens. Ohio's refusal to extend the credit to ethanol produced in Indiana unless Indiana provides a similar credit for ethanol produced in Ohio thus does not interfere with "the natural functioning of the interstate market." *Alexandria Scrap*, 426 U.S. at 806.

This fact clearly distinguishes the reciprocity decisions on which New Energy relies. In *A&P*, for example, Mississippi banned the sale of all out-of-state milk unless the producer state accepted Grade A milk from Missis-

sippi.[15] In striking down this reciprocity clause, the Court found that it had a "devastating effect upon the free flow of interstate milk." 424 U.S. at 375, and did not serve any legitimate interest of the state. Similarly, in *Sporhase*, Nebraska banned the withdrawal of ground water intended for use in any adjoining state unless that state granted reciprocal rights for the use of its water in Nebraska. This reciprocity provision, which did not significantly advance any legitimate state interest, 458 U.S. at 958, "operate[d] as an explicit barrier to commerce between" Nebraska and Colorado, *id.* at 957, and prevented commerce in water that otherwise would have occurred.

This case presents facts quite different from those in *A&P* and *Sporhase*.[16] In each of those cases, the challenged reciprocity provisions burdened interstate commerce by preventing or drastically reducing the flow of goods across state lines. In light of New Energy's admission that it would be unable to sell ethanol in Ohio without the Ohio incentive, the same cannot be said here. Because it provides a tax incentive to all out-of-state ethanol except ethanol from states lacking similar incentives, the Ohio statute is a narrowly tailored means of *encouraging* interstate commerce in ethanol among all the states. The statute invites cooperation, not retaliation, from other states, in an attempt to promote a broad

[15] But for this reciprocity clause, a Louisiana producer was ready, willing, and able to supply wholesome milk to Mississippi; the only thing that prevented it from doing so was Mississippi's refusal to permit such sales. 424 U.S. at 369-70.

[16] Another contrast between § 5735.145(B) and the statutes in *A&P* and *Sporhase* is that the Ohio statute does not absolutely ban the sale of out-of-state ethanol; it merely denies a partial tax credit to the dealers who purchase such ethanol.

interstate market for ethanol.[17] In no sense can Ohio be said to have "threaten[ed] complete isolation as the

[17] Unlike the reciprocity provisions struck down in *A&P* and *Sporhase*, § 5735.145(B) does not "invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause." *A&P*, 424 U.S. at 380 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951)). In fact, in the peculiar context of the government-subsidized ethanol market, such balkanization of the market is more likely to be created by statutes that provide incentives for ethanol use and production but do *not* contain a reciprocity provision. Such statutes create markets for ethanol use and production only in the enacting states. Reciprocity provisions like Ohio's are better suited to encouraging *all* states to open their markets to both in-state and out-of-state ethanol.

The reciprocity provision of the Ohio statute prevents it from violating the "internal consistency" test that this Court has recently applied in analyzing certain state tax laws. The Ohio tax is such that, "'if applied by every jurisdiction,' there would be no impermissible interference with free trade." *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644 (1984) (quoting *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, (1983)); *see also Tyler Pipe Indus., Inc. v. Washington Dept. of Rev.*, 107 S. Ct. 2810 (1987). On the contrary, the adoption by every state of "the precise scheme here," *Armco*, 467 U.S. at 644, would not interfere with free trade but would instead be the very means by which interstate trade in ethanol could flourish. New Energy loosely interprets the internal consistency test as allowing an analysis of the Ohio statute which assumes that other states adopt reciprocity provisions similar to Ohio's in granting a credit but differing in the amount of credit offered. Brief for Appellant at 27 n.9. This Court has never applied the test in this manner, but has instead analyzed the impact of every state's adoption of an *identical* statute, which includes identical tax rates. *See Armco*, 467 U.S. at 644.

In any event, the applicability of the internal consistency test to § 5735.145(B) is doubtful. In the cases establishing and applying that test, the Court was concerned with preserving free trade among the states in the face of state laws imposing heavier tax burdens on nonresident taxpayers than resident taxpayers. *See Tyler Pipe; American Trucking Assn., Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). Unlike the nonresident taxpayers in those cases, New

alternative to acceptance of its offer of reciprocity" or "use[d] the threat of economic isolation as a weapon to force sister States into even a desirable reciprocity agreement." *A&P*, 424 U.S. at 379. Ethanol from Indiana is not barred from the Ohio market, and New Energy is free to sell in Ohio if such sales are warranted by private market forces. The contrast between the absolute prohibition in *A&P* and the withholding of an incentive here is clear, for the only "economic isolation" that results here is that very isolation that would exist if Ohio had done nothing at all.

Invalidation of § 5735.145(B) would require a conclusion that the Commerce Clause prohibits a state that has decided to use its laws to make economically viable a product for which there would otherwise be no market from structuring its incentive in such a way as to encourage other states to provide similar incentives, thus opening up a national market for the product. There is no basis for such a result.

III. Ohio Rev. Code § 5735.145(B) Has Neither The Purpose Nor The Effect of Protecting Local Producers At The Expense Of Interstate Commerce.

The Ohio Supreme Court correctly focused on the ultimate issue in this case: whether the statute had as its purpose or effect economic protectionism. This Court has consistently prohibited states from favoring local producers at the expense of interstate commerce. *See, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984);

Energy is "not in the position of a foreign business which enters a State in response to completely *private* market forces to compete with domestic businesses, only to find itself burdened with discriminatory taxes or regulations." *Alexandria Scrap*, 426 U.S. at 810 n.20 (emphasis added). Instead, § 5735.145(B) encourages the opening of an interstate market for all ethanol producers, including New Energy.

Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333 (1977); *see generally* Regan, *supra*. As the Supreme Court of Ohio properly found, however, § 5735.145(B) is not protectionist in either its purpose or effect. *New Energy Co. v. Limbach*, 32 Ohio St. 3d 206, 207, 513 N.E.2d 258, 259 (1987) (J.S.A. 4a).

If the Ohio legislature had wanted to protect Ohio ethanol producers from out-of-state competition, § 5735.145(B) was a highly impractical means to achieve that end. It would have been much more effective to directly subsidize only in-state producers, as Indiana did, or to subsidize them indirectly by limiting the Ohio incentive to ethanol produced in Ohio. Ohio instead enacted an incentive that applied not only to in-state producers but also to producers from numerous other states, including Illinois, home of the nation's largest ethanol producer. The Ohio legislation did nothing to insulate Ohio producers from competition with producers from these states. On the contrary, the statute encourages such out-of-state producers to enter the Ohio market.

The presence of this vigorous interstate competition for Ohio business contrasts sharply with the situation in the cases cited by New Energy. For its argument that the Ohio statute unconstitutionally discriminates against out-of-state businesses, New Energy relies upon *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), and *Bacchus Imports*. In both of these cases, the statute at issue treated out-of-state competitors differently from local competitors in order to confer on the "home team" economic advantages unavailable to any outsider.

For example, in *Boston Stock Exchange* the state taxed all out-of-state stock transfers but no in-state transactions. As a result, in-state stock exchanges were totally insulated from competition with out-of-state

firms. This complete protection from out-of-state competition was the determinative factor in the Court's decision:

> [T]he fundamental principle that we find dispositive of the case now before us [is]: No State may, consistent with the Commerce Clause, "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business."

429 U.S. at 329; *see also Bacchus Imports*, 468 U.S. at 271-272.

This dispositive factor of protectionism is totally absent in this case. Section 5735.145(B) does not give the "home team" any advantage at the expense of all "outsiders." *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978) (no unconstitutional discrimination in the absence of a protectionist purpose, although virtually all those advantaged by the statute were "insiders" and those disadvantaged were "outsiders"). The Ohio statute does not discriminate against interstate commerce to protect a domestic producer.[18]

The facts adduced at trial show that all interstate competitors in the Ohio market, except New Energy, received the Ohio credit. (Finding 17, J.A. 28). Further, it is undisputed that these interstate competitors were ready, willing, and able to supply New Energy's portion of the Ohio ethanol market, if New Energy withdrew from this market. (*Id.*). New Energy attempts to combat this evidence with the novel argument that "there is no reason not to think" that the Ohio statute may have

[18] The number of states and national organizations that have recognized that § 5735.145(B) is not a protectionist attempt to favor Ohio producers at the expense of interstate commerce and have filed *amicus* briefs supporting appellees' position is striking confirmation of this conclusion.

increased South Point's market share in Ohio, rather than the market share of its out-of-state competitors. Brief for Appellant at 24. But New Energy, as challenger to the Ohio statute, has the burden of proving that the statute is unconstitutionally discriminatory. *See, e.g., Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). New Energy cannot escape its failure to prove any discrimination against interstate commerce by simply assuming that such discrimination exists.

New Energy attempts to obscure its failure of proof by speculating that the legislature must have had a protectionist motive, based on certain technical definitions in the statute. New Energy claims that if Ohio's purpose were truly to encourage the use of ethanol, it would have allowed a credit for ethanol from every state, no matter whether or not such states promoted ethanol use or by what means they did so. Brief for Appellant at 33-34. But if Ohio had not restricted its credit to ethanol produced in states with similar incentives, the statute would be unable to fulfill the legislative goal of encouraging other states to enact such incentives and thus creating an interstate market for ethanol. New Energy also claims that Ohio's purpose could not really be "serious," or else the statute would not define ethanol as being produced either (1) in a manufacturing facility with a capacity of less than two million gallons and from wood or the grain of a cereal grass or (2) from a coal-fired process from wood or the grain of a cereal grass. *Id.* at 34. New Energy has never claimed that this definition of ethanol restricts any producer, not even itself, from being eligible for the Ohio incentive. In fact, New Energy's own proof at trial establishes that almost all United States ethanol is produced from corn (the grain of a cereal grass) and that the producer with the highest production capacity in the country is eligible for the Ohio credit. (J.A. 56, 77,

135). New Energy failed to prove that the Ohio legislature had any protectionist purpose for enacting § 5735.145(B).

Having failed to prove any protectionist purpose, New Energy next interprets the record quite generously in an attempt to imply that Ohio enacted § 5735.145(B) to retaliate against Indiana for taking its ethanol tax credit away from South Point. Brief for Appellant at 31. The record is devoid of evidence of any such retaliatory purpose. New Energy can only point to the testimony of its own chief executive officer concerning *his* belief that South Point lobbied for passage of the statute to put pressure on Indiana to enact an ethanol tax credit. Brief for Appellant at 31 (quoting J.A. 123).

The testimony of South Point's general manager only verifies that South Point sought "an incentive to *all states* to enact all legislation that would promote the sale of ethanol in their states." (J.A. 139 (emphasis added)). This purpose coincides with the trial court's finding of legislative purpose. (J.S.A. 63a). As previously discussed, such a purpose is valid because the reciprocity provision was not designed to promote the in-state business of Ohio producers, but rather to enhance their ability to do business outside Ohio. Once again, New Energy has failed to satisfy its burden of proving that the Ohio statute is unconstitutionally discriminatory.

IV. New Energy Failed To Prove At Trial That Ohio Rev. Code § 5735.145(B) Imposes A Burden On Interstate Commerce.

At every level of appeal of this case, New Energy has been unable to surmount the barrier of its failure to prove — or even to present any evidence — at trial that the Ohio statute imposes a burden on interstate commerce. Instead, New Energy merely asserts that the reciprocity provision "discriminates" against interstate

commerce, and asks this Court to declare the statute unconstitutional without any supporting evidence. In fact, New Energy purposely created a situation where the courts could only speculate as to the existence of any burden that might result from the statute, by seeking trial on an expedited basis before the statute became effective rather than waiting to see what its actual impact would be. New Energy then asked the courts to ignore long-established principles of constitutional decision-making and to declare that the statute unconstitutionally burdens interstate commerce based purely upon speculation, rather than evidence.

This Court has traditionally applied two separate tests for measuring the states' compliance with the Commerce Clause:

> where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected.
>
> . . .
>
> But where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a much more flexible approach. . . .

Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978). The "more flexible approach" was first articulated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970): when the statute "effectuate[s] a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." The party challenging a statute under the Commerce Clause has the burden of establishing that the statute imposes a burden on interstate commerce. *See, e.g., Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

New Energy asks the Court to reject the flexible *Pike* balancing test in favor of the "strictest scrutiny" represented by the "virtually per se rule", simply because the Ohio statute has a reciprocity provision. Brief for Appellant at 18. Rather than analyzing the statute using the "strictest scrutiny," however, New Energy simply argues that § 5735.145(B) is unconstitutional because it is "facially discriminatory." This Court has never rejected reciprocity provisions on this basis alone; to do so would be to apply an absolute per se rule because reciprocity provisions by their very nature distinguish based upon state lines.

Indeed, the Court has not generally applied the "virtually per se rule" to reciprocity provisions. *See A&P; see also* Smith, *State Discrimination Against Interstate Commerce*, 74 Cal. L. Rev. 1203, 1240-1241 (1986) (reciprocity statutes not necessarily discriminatory; they may have the purpose and effect of eliminating the difference in treatment between those inside and outside the state). To do so would be particularly inappropriate in this case where no "simple economic protectionism" has been proved and where the statute benefits numerous out-of-state ethanol producers to the same extent that it benefits Ohio producers.[19]

To warrant invalidation of § 5735.145(B) under the Commerce Clause, then, New Energy had the burden to prove — not hypothetically, but with substantive evidence — that (1) the provision imposes a burden on interstate commerce, and (2) the burden imposed clearly outweighs any legitimate state interest advanced

[19] Even under the "virtually per se rule", this Court has recognized that "[n]ot all intentional barriers to interstate trade are protectionist. . . ." *Maine v. Taylor*, 106 S. Ct. 2440, 2453 n.19 (1986). Because § 5735.145(B) was narrowly tailored to its legitimate purpose of expanding the interstate market for ethanol, the statute should survive even strict review.

in support of the statute. *Pike*, 397 U.S. at 142. The record below and the findings of the trial court establish that New Energy failed to meet its burden of proof on these issues.[20]

New Energy attempts to avoid this absence of proof by presenting self-serving statements made by one of its officers two and three years after trial concerning financial hardship allegedly suffered by New Energy. This "evidence" was not part of the record before the trial court and is therefore not properly before this Court.

Even if any information about the impact of the statute on New Energy's participation in the Ohio market were in the record, New Energy's effort to prove that the Ohio statute burdens interstate commerce focuses entirely on the impact of that statute on New Energy's own business. This Court has stated, however, that "[t]he fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon*, 437 U.S. at 126; *see also CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1649 (1987). The challenged statute in *Exxon* prohibited a producer or refiner of petroleum products from operating any retail service station within the state of Maryland. The plaintiff complained that the statute would require it to stop selling its product in Maryland. The Court concluded, however, that the plaintiff's withdrawal from the market would not warrant:

> . . . a finding that the statute impermissibly burdens interstate commerce.
>
> . . .

[20] Because New Energy failed to offer *any* evidence of a burden on interstate commerce, this Court need not analyze the extent of any such burden in relation to the purposes supporting the statute. *See Pike*, 397 U.S. at 142.

> Some refiners may choose to withdraw entirely from the Maryland market, but there is no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners. The source of the consumers' supply may switch from company-operated stations to independent dealers, but interstate commerce is not subject to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another.

Exxon, 437 U.S. at 127. In other words, the Commerce Clause is concerned with the impact of a statute on the total flow of interstate commerce from all sources rather than the potential impact upon a single company. *Id.* at 126 n.16; *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 474 (1981).

This analysis of the Commerce Clause does not mean that a state may arbitrarily discriminate against a particular business. Instead, it recognizes that the protection of specific firms stems from the Equal Protection Clause, not the Commerce Clause. As this Court recently explained: "The two constitutional provisions perform different functions in the analysis of the permissible scope of a State's power — one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States." *Ward*, 470 U.S. at 881 (footnote omitted).

New Energy initially brought its claim under the Equal Protection Clause as well as the Commerce Clause. After this Court announced its decision in *Ward*, New Energy withdrew its Equal Protection claim. New Energy now attempts to base its Commerce Clause claim on evidence that goes, at best, to the Equal Protection question rather than to the issue of a burden upon interstate commerce taken as a whole.

New Energy presented no evidence of any burden on any other out-of-state ethanol producer or on the general flow of ethanol into Ohio from outside the state, other than its novel assertion that "there is no reason not to think" that the statute decreased the market share of out-of-state producers. Brief for Appellant at 24. The record shows, however, that a minimum of three out-of-state producers sell ethanol in Ohio, are eligible for the Ohio incentive, and have adequate capacity to replace the share of the market served by New Energy. (Finding 17, J.A. 28). Thus, the purported "competitive disadvantage" of which New Energy complains is not limited to a comparison with merely local producers, but includes several interstate competitors as well. Indeed, because the Ohio statute actually creates an interstate market that would not otherwise exist, it makes no sense to characterize the statute as creating the type of burden with which the Commerce Clause is concerned. *See Alexandria Scrap*, 426 U.S. at 805.

New Energy has not proved that the Ohio statute imposes *any* burden on interstate commerce, let alone a "clearly excessive" burden. *See Pike*, 397 U.S. at 142. The lower courts correctly applied the constitutional test mandated by this Court and held, as a result, that New Energy had failed to establish its claim challenging the constitutionality of § 5735.145(B).

CONCLUSION

The courts below properly held that § 5735.145(B) was not enacted for purposes of economic protectionism, that the Ohio legislature had a legitimate purpose for enacting the statute and that New Energy failed to prove that the statute imposed a burden upon interstate commerce. For the foregoing reasons, the Court should affirm the judgment of the Supreme Court of Ohio declaring § 5735.145(B) to be constitutional.

Respectfully submitted,

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